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November 1, 2011

VIA ELECTRONIC MAIL – To: Regs.Comments@federalreserve.gov

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No. R-1429, RIN NO. 7100 AD 80

Dear Ms. Johnson:

This law firm represents depository institutions and has numerous savings associations and savings and loan holding company (“SLHC”) clients, both in the stock and mutual structure. It is in that capacity that we submit this comment letter on the Federal Reserve Board’s (“FRB”) Interim Final Rule on SLHC’s, which was published in the Federal Register at Volume 76, Page 56508, on September 13, 2011.

A. General Comments

Given the transition period provided by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), the FRB has only recently assumed regulatory jurisdiction over SLHCs and interpretive authority under the Savings and Loan Holding Company Act, which is Section 10 of the Home Owners’ Loan Act (“HOLA”), 12 USC § 1467a. Consequently, both the agency and the regulated SLHCs require a transition period to familiarize themselves with each other and adapt to the regulatory restructuring. The FRB has long regulated bank holding companies and both bank holding companies and SLHCs control depository institutions. However, SLHCs and bank holding companies have historically operated under different regulatory requirements and policies. SLHCs have a separate history and legal structure and, traditionally, a different regulator, than that of bank holding companies. Additionally, SLHCs and their subsidiary associations are used to having the same regulator at both the institution and SLHC level. While certain policies may be amenable to both bank holding companies and SLHCs, the history of SLHCs cannot be lightly disregarded in favor of “one size fits all” supervision to both holding company structures.

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We believe that the FRB's general approach of copying the regulations of the prior regulator, the Office of Thrift Supervision ("OTS"), into the new FRB Regulation LL and MM is appropriate as a starting point. Given their separate background and regulatory structure, SLHCs should not be subjected to material regulatory changes without careful consideration and an acceptable transition period. However, the Dodd-Frank Act's elimination of the single regulator for savings associations and SLHCs and the division of regulatory functions between the FRB at the holding company level and the Federal Deposit Insurance Corporation ("FDIC") or Office of the Comptroller of the Currency ("OCC") at the institution level has caused unnecessarily duplicative regulatory requirements. Moreover, there are certainly aspects in which the OTS applications incorporated by the FRB can be improved. There are some immediate changes that can and should be made to reduce regulatory burden, improve the regulatory scheme and eliminate unnecessary competitive disadvantages for SLHCs. Further, the FRB, the OCC and the FDIC should undertake a comprehensive analysis of the HOLA and the OTS regulations carried forward with a goal of eliminating as much duplication of regulation as possible, while streamlining the regulatory process for SLHCs. Although the temporary incorporation of OTS regulations is prudent, mechanical acceptance of those regulations for the long term without due analysis is not. Finally, the FRB should consider whether certain approaches taken by OTS in its SLHC regulations are more effective than those currently taken by FRB regulations as to bank holding companies, such that those approaches could be incorporated and applied to both SLHCs and bank holding companies. Many of our comments suggest ways in which the regulatory scheme for both SLHCs and bank holding companies can be improved.

B. Regulation LL

1. Applications

We generally agree with the FRB's replacement of the OTS' application processing procedures with those currently used for bank holding companies by the FRB. Our experience is that the FRB's 30 to 60 day application processing procedures are generally efficient and effectively balance regulatory requirements with the market's need for reasonable promptness in consummating corporate transactions. However, applications relating to mutual-to-stock conversions reflect special timing considerations, discussed later in our comments to Regulation MM, that may require the FRB to adjust its process to facilitate such transactions.

(a) Exceptions

In particular, we applaud the FRB's creation of a regulatory exception (12 CFR § 238.12(d)(1)) from an application requirement for an SLHC that acquires control of the shares of another savings association (such as, for example, through a merger with the target holding company) but then immediately merges the target association into its existing savings association subsidiary. The exception is subject to certain conditions similar to those applicable to the identical exception for bank holding companies at 12 CFR 225.12(d)(1), including that the

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merger between the institutions be subject to a Bank Merger Act approval and that a waiver filing be made with the FRB. As the FRB's preamble notes, the substance of the transaction is the merger between the two savings associations, which is subject to review by the applicable federal regulator under the Bank Merger Act. In such circumstances, no regulatory purpose is served by a largely duplicative review of a holding company application by the FRB. That is true whether the acquiring holding company is a bank holding company or a SLHC.

In that regard, we suggest that the SLHC exception at 12 CFR § 238.12(d)(1) and the comparable bank holding company exception at 12 CFR § 225.12(d)(2) be modified to include acquisitions of *both* banks and savings associations where a Bank Merger Application is necessary and the other conditions are met. Right now, the SLHC exception solely refers to acquisitions of other savings associations and the bank holding company exception to acquisitions of other banks. We see no legal or policy reason to limit the exceptions in that manner since the policy basis for the exception is the same regardless of which type of institution is being acquired through merger into another institution. The regulations should be modified to specifically include acquisitions of shares of both banks and savings associations within the exception for each of SLHCs and bank holding companies where the institutions are immediately merged and the other conditions are met.

The FRB's adoption of another exception from SLHC application requirements for internal corporate reorganizations (12 CFR § 238.12(d)(2)), on similar terms and conditions applicable to an existing exception for bank holding companies (12 CFR 225.12(d)(3)), also represents sound policy. Such transactions do not create substantive issues and elimination of the application requirement reduces regulatory burden.

In light of the FRB's adoption of these exceptions, which are modeled on similar exceptions for bank holding companies, we wonder why the interim final rule does not contain language based on the exception for bank holding companies found at 12 CFR 225.12(d)(1). That exception confirms that a simple merger of a subsidiary bank with another bank (*i.e.*, one that does not involve the holding company's acquisition of the target institution's shares at any time) does not require a bank holding company application (or a waiver filing) so long as an approval for the bank merger is necessary under the Bank Merger Act. Similar language should be added to the interim final rule for SLHCs but should be broadened to include mergers by the subsidiary savings association with both banks and savings associations so long as a Bank Merger Act approval is required. Section 225.12(d)(1) should also be amended as necessary to expand the present exception for bank holding companies to include mergers with savings associations as well as banks.

(b) Application Forms

The FRB carried over the OTS' application forms applicable to SLHCs, the H-(e) forms, with certain technical changes. In our experience, the OTS' H-(e) application forms are unduly

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burdensome and costly for SLHCs to prepare; much more so than the FRB's FR Y-3 form. We urge the FRB to undertake an expeditious section by section review of the H-(e) form and eliminate unnecessary and redundant information requests, if it intends to use the H-(e) forms going forward. Alternatively, the FRB could transition SLHCs to the FR Y-3 form, or a modified version of the FR Y-3 form as revised to obtain any information particular to SLHC transactions.

2. Control Determinations

The FRB's interim final rule eliminates the regulatory scheme established by OTS for control determinations, including the passivity commitments and rebuttal agreements permitted under OTS control regulations. Instead, the FRB, at 12 CFR § 238.21, applies to SLHCs the practices and policies that it uses with respect to bank holding companies. We know of no reason that control determinations regarding SLHCs are inherently different from those involving bank holding companies and the FRB's approach presents the advantages of uniformity and simplicity. However, the OTS' regulation provided the benefits of more certainty and efficiency in some cases, given the detailed control factors and the explicit regulatory procedures for rebutting control, than the FRB's existing less formal agency control determinations. We urge the FRB to carefully consider whether some of the features of the OTS control analysis in its regulation (such as those mentioned above) can be incorporated into FRB regulations and applied to both bank holding companies and SLHCs.

3. Activities

(a) Filings

Regulation LL, at 12 CFR § 268.61 *et. seq.*, implements Section 606(b) of the Dodd-Frank Act, which establishes certain requirements for SLHCs that desire to engage in activities permitted for financial holding companies. The interim final rule requires an SLHC to file with the FRB an election to be treated as a financial holding company and a certification that the statutory criteria are satisfied prior to engaging in activities permitted for financial holding companies. These procedures are similar to those in place for a bank holding company to engage in financial holding company activities. We understand the interim final rule to provide that these requirements apply only where the proposed activity is permissible for the SLHC *solely* under the financial holding company authority. If the proposed activity is permissible for an SLHC under both the financial holding company authority and another provision of Section 10 of HOLA, the SLHC may proceed under the alternative authority and need not make financial holding company filings or comply with financial holding company requirements. We agree with the FRB's position since, in addition to non-banking activities like insurance and investment banking, financial holding companies may engage in activities that are closely related to banking such as lending and trust company functions and there is no regulatory basis to impose financial holding company requirements on the conduct of such activities.

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We note, there are discrepancies between the FRB's discussion of the interim final rule and the language of the interim rule itself. The interim final rule, for example, says (on page 56511) "[A]ny SLHC that begins a new section 4(c)(8) Activity after the transfer date and has not made a [financial holding company] declaration and submitted the appropriate post-notice will need to comply with the relevant filing requirements in subpart F of this rule." However, the referenced subpart F (12 CFR § 238.52(a)(1)(i)) exempts from the general activities restrictions contained in 12 CFR § 238.51(b) "[a]ny savings and loan holding company (or subsidiary of such company) that controls only one savings association, if the savings association subsidiary of such company is a quantified thrift lender as defined in § 238.2(k)." Consequently, according to the interim final rule, any unitary SLHC whose savings association subsidiary complies with the quantified thrift lender test would not need to file anything in order to engage in 4(c)(8) activities since it is exempt from activities restrictions. That discrepancy needs to be corrected.

(b) Real Estate Investment

An issue related to SLHC activities that deserves comment is real estate investment/development. Notwithstanding that such activities are not permitted for bank or financial holding companies, they have long been authorized for SLHCs, whether unitary or multiple. See, e.g., 12 CFR § 584.2-1(b)(4), (5), (6), (7), (8) (2010). The permissibility of that activity for SLHCs has been confirmed by statute. See USC § 1467a(c)(2)(F)(ii) (stating that SLHCs may engage in any activity authorized by regulation for multiple savings and loan holding companies as of March 5, 1987 (which includes real estate investment)). As was noted in the interim rule itself (76 Fed. Reg. 56511 (September 13, 2011)), that authority was undisturbed by the Dodd-Frank Act. We are unaware of any systemic supervisory problems identified by OTS that were caused by the prudent conduct of such activities at the SLHC level, nor has there been a history of on-going abuse of the authority by savings associations and their SLHCs.

Real estate investment development activity is not an activity conducted in by bank holding companies and the FRB has often sought commitments from bank holding company applicants that restrict real estate investment activities, even through subsidiaries of the bank. However, the clear authority for SLHCs to engage in such activities makes it incumbent upon the FRB to continue to allow SLHCs to engage in real estate investment activity with reasonable supervision and regulation. Failure to do so would eliminate one of the primary remaining advantages of the SLHC form of structure in a manner that is inconsistent with the legislative and OTS regulatory intent to permit this activity.

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(c) Subsidiaries of Subsidiary Savings Associations

On the general topic of SLHC activities, we have been advised that the FRB may interpret Section 10(c)(4) of HOLA to require that a SLHC file an application with the FRB in order for its *subsidiary savings association* to establish or acquire a subsidiary. We think this is an incorrect position, both as a legal and policy matter, and should not be adopted.

Initially, it is worth noting that the interim final rule itself is inconsistent with the position that the creation or acquisition or subsidiary by a federal savings association requires prior FRB approval. The interim final rule (12 CFR § 238.53(i)) says that the FRB “hereby approves without application,” the furnishing or performing of certain specified activities (*i.e.*, those specified in 12 CFR § 545.74 as in effect on March 5, 1987) if conducted by a service corporation subsidiary of the savings association. That approach is consistent with long-time OTS policy that only a filing by the savings association is necessary to establish a subsidiary under the association regardless of whether a SLHC is in the organizational structure. Thus, the formation or acquisition of such a service corporation is not subject to a FRB application requirement pursuant to its own interim final rule.

Further, operating subsidiaries may only engage in activities permitted for the institution itself (*See* 12 CFR §§ 559.3(e)(i)(2010) (OTS regulation); 159.3(e)(i) (OCC version)). The establishment or acquisition of such subsidiaries have *never* been subject to an OTS SLHC approval from the day that the OTS authorized their creation. *See* 57 Federal Register 48942 (October 29, 1992) (final rule on operating subsidiaries); 57 Federal Register 12226 (April 9, 1992) (proposed rule). We recognize that OTS reviewed a notice or application filed by the association itself to establish the subsidiary, so that an application from the parent would have been duplicative. However, any FRB review is also duplicative since federal law requires that the establishment of a subsidiary by a federal savings association be reviewed by the primary federal regulator under a comprehensive statutory and regulatory scheme. *See* 12 USC § 1828(m). *See also* 12 CFR §§ 159.11; 362.15 (filings with both OCC and FDIC required prior to the establishment of subsidiary). Additional review by the FRB would represent unnecessary duplicative regulatory burden and create inefficiency. Also, since bank holding companies are exempt from filing an application with the FRB where their subsidiary bank establishes a subsidiary, 12 CFR § 225.22(e), requiring SLHCs to file applications in similar scenarios would discriminate against such entities without any discernible policy basis for such discrimination.

At a minimum, the FRB should pre-approve routine activities for savings association subsidiaries of SLHC so that no SLHC filing is required. Alternatively, it should exercise the same prudent discretion it displayed in adopting the aforementioned regulation waiving holding company applications where the substance of the transaction is a merger at the bank level that is being reviewed by a federal bank regulator under the Bank Merger Act. The principle of avoiding filings where no material regulatory purpose is served is identical in both situations.

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4. Dividend Notices

The interim final rule implements Section 10(f) of the HOLA, which requires a savings association in a SLHC structure to give the FRB at least 30 days advance notice of the payment of the proposed declaration of a dividend to the SLHC parent. However, the interim final rule (12 CFR § 238.101, et. seq.) incorporates essentially a substantive application requirement pursuant to which the FRB may “disapprove a notice.” The statutory notice requirement is duplicative of the detailed regulations governing capital distributions by savings associations. See 12 CFR § 163.140, et. seq. (OCC Version). Capital distributions by the subsidiary association are a matter of primary importance to the primary regulator of the institution. That duplication was less of a concern where OTS was regulating both the savings associations and the SLHC because only one filing was required. However, there is no sound regulatory policy supporting the regulation by two separate federal agencies of capital distributions by savings associations. To avoid the unnecessary duplication and regulatory burden, the notice submitted to the FRB should be just that: an informational filing. Any substantive regulation of capital distributions by subsidiary savings associations should continue to be through the regulations concerning capital distributions at the association level. We recommend that the FRB revise the final rule accordingly.

C. Regulation MM

Given the magnitude of the FRB’s changes to the Dodd-Frank Act’s statutory provisions on dividend waivers by mutual holding companies (“MHCs”), this law firm is submitting a separate comprehensive comment letter on that topic alone. However, there are other aspects of Regulation MM that are discussed below.

1. Operational Restrictions.

As a general proposition, we believe that the OTS regulations on MHCs, upon which the FRB’s interim final rule was based, were too paternalistic toward such companies. We recognize that, in the early 1990’s, MHCs were a relatively new structure and the OTS therefore sought to comprehensively regulate such entities while becoming accustomed to the issues surrounding the structure. However, the necessity of that attitude has long since past, as the MHC structure is now twenty-five years old. In many respects, there is now no basis to impose greater regulation on MHCs than applies to their stock counterparts. The OTS recognized this to be the case over time through regulation, policy and the granting of waivers as it familiarized itself with the structure and business conduct of MHCs.

(a) Stock Pledges

In that regard, we support the FRB’s elimination of the OTS’ requirement that MHCs provide a 10-day after-the-fact notice of pledges of the stock of subsidiary savings associations

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or subsidiary mid-tier holding companies. The FRB noted that many concerns arising from such pledges could be adequately addressed through the supervisory process, and we agree. In light of the FRB's posture in that regard, we do not believe the FRB needs to retain other requirements such as a 30-day regulatory notice requirement for the proposed disposition of any stock of a subsidiary savings association, including in connection with a pledge (12 CFR § 239.7(b)(1)), and restrictions on the use of proceeds from loans collateralized by such stock (12 CFR § 239.8(b)(1)). Such requirements are not imposed on stock holding companies and the FRB gave no indication as to why the retention of these OTS requirements was necessary. Any issues arising from such situations can be addressed through the usual supervisory process.

(b) MHC Activities

We also note the sections of the interim final rule pertaining to the business activities and investments of MHCs, 12 CFR § 239.7 and 239.8(a). Generally, the OTS regulations upon which these sections of the interim final rule was based were poorly written and unclear. The FRB's interim final rule, therefore, suffers from the same defects. For example, the interim final rule refers in several places to "non-controlling investments" by MHCs without ever defining the term. The language in the interim final rule that imposes prior approval and other requirements on an MHC's "non-controlling investments" in savings associations, SLHCs, and other corporations can, therefore, be interpreted to apply to even investments of less than 5% of a class of voting stock of SLHCs, savings associations and other corporations. That would directly conflict with HOLA, which authorizes a SLHC to make such investments without restriction and without regulatory approval, 12 USC § 1467a(e)(1)(iii). See 12 CFR § 239.8(f) (MHCs are subject to laws governing SLHCs generally unless expressly provided). The OTS ultimately adopted an informal interpretation allowing such investments by MHCs without prior regulatory approval. See 72 Fed. Reg. 72238 (December 20, 2007) ("OTS has informally taken the position that an application is not required...where an MHC proposes to hold less than five percent of the voting stock on another entity"). There is no reason why this authority should not be explicitly set forth in the interim final rule. These sections of the interim final rule would benefit from a comprehensive review and re-writing to improve clarity.

2. Conversion From Mutual to Stock Form.

Regulation MM largely adopts the OTS conversion regulations as applied to MHCs. In that regard, we have some suggestions, discussed below, as to ways in which the conversion regulations can be improved by eliminating unnecessary requirements. As a threshold matter, the FRB should recognize that the OTS conversion regulations were carefully developed over decades and, by and large, have served the thrift industry and the federal deposit insurance fund well by facilitating the raising of billions of dollars of capital. The FRB should be *extremely* circumspect about making any material changes or adopting any interpretations of the regulations that differ from those of the OTS for fear of disrupting the time-proven conversion

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process that has been accepted for years by financial markets. The old adage of not fixing what isn't broken is fully relevant here.

(a) Holding Company Loan to ESOP to Purchase Conversion Shares

Initially, the interim final rule contains an error that should be corrected. The mutual-to-stock conversion regulations of the OTS prohibited the *subsidiary savings association* from providing a loan to any person for the purpose of purchasing conversion stock. In this regard, the regulation provided, in relevant part, "You [savings association] may not extend credit to any person to purchase your conversion shares." 12 C.F.R. § 563b.345(b). The OTS regulation did not prohibit the savings association's *holding company* from making a loan to its employee stock ownership plan ("ESOP") to purchase conversion shares in the offering. Indeed, for many years, conversions have routinely included a holding company loan to the newly established ESOP to purchase conversion shares, based on the ESOP's status as an eligible purchaser, under the plan of conversion and applicable OTS regulations.

The preamble to 12 CFR 239.59 of the interim final rule (relating to the offer and sale of conversion shares) provides, in relevant part:

This section [239.59] contains provisions governing the offering, pricing, purchase limitations, and timing restrictions of an offering of stock in connection with a conversion. These provisions were contained in sections . . . 563b.345 . . of the OTS regulations and have been revised to reflect nomenclature changes and the change in supervisory authority.

[emphasis added.]

Therefore, based on the preamble, one would expect that the OTS regulations were carried forward in the interim final rules without any material changes.

However, in reviewing Section 239.59 of the interim final rule, it became apparent that there was an unintended error in the adoption of the rule. Section 239.39(f) of the interim final rules provides that:

(f) *Payment for conversion shares.*

- (1) A subscriber may purchase conversion shares with cash, by a withdrawal from a savings account, or a withdrawal from a certificate of deposit. If a subscriber purchases conversion shares by a withdrawal from a certificate of deposit, the mutual holding

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company or its subsidiary savings association may not assess a penalty for the withdrawal.

(2) The mutual holding company may not extend credit to any person to purchase the conversion shares.

[Emphasis added.]

The unintended consequence of the underscored language could be to prohibit a holding company from making a loan to its ESOP for the purpose of purchasing conversion shares. This would effectively overturn years of OTS-approved conversions where holding companies provided such loans to their ESOPs to purchase shares. It also could be interpreted to prevent SLHCs from funding their ESOP's purchases of conversion shares in future conversions, a position that would disrupt the settled conversion process.

We assume that the preamble to the interim final rule is correct and that the revisions to 12 C.F.R. § 563b.345 were intended to be changes to nomenclature and reflect the FRB's new supervisory responsibility over savings and loan holding companies, rather than substantive. Certainly, any substantive change to the established mechanism of a holding company lending funds to the ESOP for conversion stock purchases would be significant and require notice and comment rulemaking that was not employed prior to the adoption of the interim final rule. The current version of Section 239.59(f) of the interim final rule should, therefore, be revised to either delete subsection (2) entirely, refer to loans by the savings association subsidiary instead of the MHC or, at a minimum, exclude loans from a holding company to its ESOP for the purpose of purchasing conversion shares. We believe this treatment is warranted by prior practice and the former OTS regulations.

(b) Allocation of Orders for Conversion Stock

The interim final rule, at 12 CFR 239.59(p)(2), provides that if a converting MHC offers its conversion stock in a community or public offering, it must first fill orders for its stock up to a maximum of 2% of the conversion stock on a basis that will promote a widespread distribution of stock, and that any remaining shares must be offered on an equal number of shares per order basis until all orders are filled. Typically, converting companies seek to achieve a widespread distribution of conversion stock by selling to a large number of different purchasers, including depositors in the subscription offering and retail and institutional investors in the syndicated community offering. However, allocating shares on an equal number of shares per order basis in a syndicated community offering is neither practical nor in the best interests of the converting companies or the successful completion of transactions. Orders from institutional investors may be price and quantity sensitive, and each of the investors will have its own threshold for deciding whether to purchase stock. Converting companies are typically advised by their financial advisor that flexibility in allocating shares in a syndicated community or underwritten public offering is

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necessary in order to achieve a successful conversion. Consequently, waivers of this provision of the regulation were routinely requested of, and granted, by OTS. We anticipate the same thing occurring with the FRB. We therefore suggest that this language be deleted from the regulation altogether. The requirement makes no sense in the current environment, serves no useful purpose and causes unnecessary regulatory burden.

(c) Registration of Conversion Shares

The interim final rule, 12 CFR 239.61(g)(1), also requires that a converting company register its shares under the Securities Exchange Act of 1934 and not deregister the shares for three years after conversion. We believe that the three-year requirement should be deleted. Many conversions involve companies with fewer shareholders than the threshold for registration under SEC requirements and could deregister sooner but for that provision requiring a three-year registration. Remaining a public company is a significant burden on a small company and we fail to see the justification for the requirement where not provided for by securities laws and regulations. Additionally, there are various legislative proposals currently pending that would *raise* the number of shareholders required both for SEC registration and deregistration. These proposals recognize the need to facilitate capital-raising by small companies without the extensive and ever-increasing and costly regulatory burden placed on public companies. The FRB should also act to implement this policy.

(d) Timing

At the outset, we noted that the FRB's usual 30 to 60 day application time frame sufficiently balances the applicant's (and market's) desire for expeditious processing with the agency's need for analysis of the proposed transaction. There is an exception to that general comment which involves applications by MHCs to convert to stock form. Such transactions must be coordinated with other regulators' processing mechanisms; in particular, that of the Securities and Exchange Commission ("SEC"). Failure to receive FRB approval of a stock conversion in sufficient time to meet the SEC's requirements for current financial statements in the prospectus results in costly and time-consuming financial statement updates. It also causes greater market uncertainty since the appraisal has to be updated to reflect new business and financial information and changes that have occurred in the markets.

The OTS, recognizing the substantial benefits of conversions, was extremely sensitive to the timing considerations involved in the process and worked diligently to allow applicants to meet the applicable timing requirements. Mutual-to-stock conversion is an area where the FRB should not rely on internal processing guidelines but rather adopt an attitude of doing what is necessary to facilitate the conversion so long as the applicant files its materials in reasonably timely fashion. Again, mutual-to-stock conversion involves a balancing of the timing requirements of various agencies and the FRB's cooperation is needed, as was that of OTS, to allow conversion applicants to successfully maneuver through the process.

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Thank you for considering these comments. Please contact us if we can provide further information.

LUSE GORMAN POMERENK & SCHICK, P.C.

A handwritten signature in cursive script, reading "Luse Gorman Pomerenk & Schick". The signature is written in dark ink and is positioned below the printed name of the firm.